Audit's NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS

Realty Trust Review

December 12, 1975 VOL. VI, No. 23

INVESTMENT POLICY AND REVIEW ISSUE

VALUE GUIDE TO REITS REVIEWED THIS ISSUE

Trust	Rel. Appeal	Port. Yield	-12 Mo.Port.Chng.- Last	E.Next	Lever Ratio	Price	Ann. Yield**	Div. Reinv.	Page
Gulf Mtg.	5	7.20%	+ 1%	- 5%	4.4	$ 1.13	0.0%	Yes	6
Hotel Inv.	3	10.64	-13	+10	1.8	10.00	14.0	Yes	4
M&T Mortgage	3	10.24	- 5	- 5	1.6	6.50	16.0	Yes	6
North Amer. Mtg.	4	8.84	-17	- 5	2.2	5.13	19.5	No	7
Wells Fargo	4	7.97	-20	-10	2.1	4.13	0.0	Yes	5
AVERAGE		8.98%	-11%	- 3%	2.4		9.9		

**Based on annualized latest qtr.

Your editor has prepared a major speech titled REITS AND REALITY. Copies are available by sending a self-addressed stamped (19¢) envelope to our offices.

REIT BONDS: LONGER-TERM BANK AGREEMENTS GIVING NEW LIFE TO SOME REIT BONDS

Commercial banks are starting to give longer term credit agreements to some REITs that in effect mean you can operate in the tricky REIT bond market with less risk than described in our Nov. 14 discussion. Essentially the banks are giving some REITs credit agreements running three to five years, instead of the one to 1½ year agreements that have been standard until now. These longer term agreements don't remove all the risk from REIT bonds but they do give some assurance that you can collect interest payments on such debt while the credit agreements are in force.

There's one important caveat you should understand before buying REIT bonds en masse however. Not all the groups of line banks are going with all REITs on longer term agreements. In recent negotiations, some banks are now saying they won't wait five, seven or more years to get their money back. Thus you can expect that some banks may try to "pull the plug" on some REITs and demand their money back immediately, in effect forcing those REITs into bankruptcy. For this reason we believe the risk of a relatively few and unexpected bankruptcies is higher now than in months. Two bits of evidence suggest correctness of this view of the stance of some banks at present:

--Some banks have told First Mortgage Investors they may not sign FMI's massive debt restructuring and $400 million credit agreement, even though they signed the letter of intent earlier. FMI's restructuring has been in negotiation and acceptance stages this entire year and although all shareholder and debtholder groups have approved the plan, holders of about $3 million of the $16 million 9% senior notes haven't yet gone along with an alternate maturity payment plan that is a very small but crucial piece of the overall plan. FMI management continues to press noteholders to accept the revised payments (25% of principal now, 10% each six months thereafter until a final 25% on Nov. 1, 1978) but the final holdouts are most difficult to persuade. The possibility that some banks may pull out of the $400 million line even if the

KENNETH D. CAMPBELL, EDITOR AND PUBLISHER, BERNARD SOLAS, C.F.A., DIRECTOR OF RESEARCH / AUDIT INVESTMENT RESEARCH, INC., 230 PARK AVENUE, NEW YORK 10017

PUBLISHED TWICE MONTHLY ON THE SECOND AND FOURTH FRIDAYS / SUBSCRIPTIONS $ 115 ANNUALLY / SINGLE COPY $ 7 / GROUP RATES ON REQUEST

tortuous ratification process is completed is obviously disappointing to FMI's current management. A Federal judge in Boston has given approval to withdrawal of an involuntary Chapter X petition against FMI if and when banks and life insurance companies sign the debt restructuring plan. If the banks don't go along, FMI managers say they may be forced to file a Chapter XI petition in defense. Under Chapter X a court-appointed trustee assumes control of a company while under Chapter XI present management remains in control as a debtor-in-possession. See our book REITS - WHAT'S AHEAD for a major discussion of the bankruptcy laws as applied to real estate debtors and REITs.

--Tri-South Mortgage Investors has been sued by a group of Eurodollar lenders seeking immediate repayment of $15 million principal and $343,000 in past due interest. The trust has made no additional comment beyond reporting the suit but negotiations are believed underway toward resolving the dispute. The Eurodollar lender action may be similar to that of four New York savings banks in filing an involuntary Chapter X petition against First Mortgage: a bold move to improve their bargaining position in workouts.

The longer-term credit agreements now taking shape are putting heavy pressure upon REITs to make principal repayments, often tying maturity to the amount of repayments (e.g., the Chase Manhattan M&R Trust agreement expires Dec. 31, 1976 but can be extended a full year if CMR repays $112½ million (about 15%) during 1976 and 1977). Here's a tally of these longer-term agreements for major troubled trusts:

Trust	Amount Mil.$	--Interest rates-- Cash min.	Conting.	Maturity	Additional terms and comments
Barnett Mtg.#	$222.8	1.0%	130%OP	12/31/78	Must repay all debt on maturity, asset sales (swaps) counting as repayment; Contingent interest to 7/1/87.
Chase Man.Tr.	761.0	2.0	115-126%OP	12/31/76*	Maturity depends on repayments; Non-earn. inv. not over $650M; Net worth & loss res. min. $86M; contingent interest to 1988.
C.I. Mtg.Gr.	286.5	2.0	3½% base; 125%OP cont.	6/30/80 approx.	3½% base inter. rises ¼% each 6 mon. after 6/76; 80% of net after 3½% applied to conting. ending 1983; Must repay 100%, incl. asset swaps
Cont. Mtg.(P)	531.8	1.0	125%OP	12/ 1/78	Must repay 30% during loan life, incl. assets swaps; cont. interest.
Grt.Amer.Mgmt.	315.0	1.0	8½%	5/31/78	Must repay 40% during loan life, incl. asset swaps; inter. cont. max. 10 yr
Guardian Mtg.	370.0	2.0	100% of net	9/ 1/78	Conting. inter. to 9/88; Repayment NR.

OP--Over prime rate. P--Pending agreement. #--Must be secured by pledge of assets Feb. 1, 1976. *--Extends to June 30 & Dec. 31, 1977 if $75M and $112½M repaid.

Two things are apparent about these six major agreements covering $2.5 billion of bank loans to these six troubled short-term construction REITs: First, all or a major share of earnings are going to be tied up for a decade or so, making the shares extremely unattractive even for speculators willing to bet on a longer-term recovery, and second, the banks are effectively signalling that they will stand ready to pay interest on subordinate debt of these issues for the next two-three years. That latter pledge isn't written into the agreements specifically but because the banks cannot afford to have subordinate debt in default, it stands to reason.

Having said that, a speculator in bonds of these six REITs has to worry about major events of default occurring which could possibly cause the banks to balk and bring a demand for repayment immediately (like the Eurodollar lenders have done to Tri-South Mtg.). Each agreement is replete with numerous conditions (e.g., Chase Trust non-earning loans cannot exceed $650 million vs. $589.5 million at May 31, 1975, and the sum of shareholder equity and loss reserve cannot fall below $86 million, vs. a $109.6 million total at May 31). The margin in these cases is paper-thin but still wide enough for speculative interest.

The Nov. 14 RTR classed the straight debt of Chase Manhattan Tr., Barnett Mtg., Great American Management & Investment (formerly Great American Mortgage Investors), and Guardian Mortgage as having extreme risk. Recent completion of credit agreements by Guardian Mtg. and Great American and movement toward agreement by Continental provides a much firmer factual basis for speculators who can afford high risk and possible bankruptcy to enter bond issues of these trusts. Several cautions should be noted:

	----Loss reserves----	
Trust	Per sh.	% of invest.
Barnett Mtg.9/75	$12.83	9.5%
Chase Man. 5/75	32.57	18.8
C.I.Mtg. 7/75	9.94	13.4
Cont. Mtg. 6/75	5.96	15.5
Great Amer.7/75	22.04	20.6
Guardian MI 8/75	21.00	13.7

Markets are extremely thin for many issues, with only Chase debt issues trading actively. Spreads between bid and asked prices are extremely wide and caution should be used in placing any orders. We suggest you try to work through several firms noted for their expertise in bond trading on such orders. Second, stock and bond trading halts for listed bonds are to be expected periodically. Three of the six (C.I. Mortgage, Chase Manhattan and Guardian Mtg.) still trade on the NYSE while the remaining three trade over the counter after trading halts by the NYSE. Recognize that book value is now negative for three (Chase Manhattan, minus $10.28/sh., Great Amer., minus $12.33/sh. and Barnett Mtg., minus $1.28/sh.) and is nominal for two others (Guardian Mtg., 7-cents, and Continental Mtg., 30-cents). C.I. Mortgage has announced impending additions to its loss reserve will "substantially" reduce its $12.89/sh. book value. With such thin or non-existent equity cushions, bond investors must look toward accumulated loss reserves for their protection. Loss reserves per share and as a percentage of outstanding investments are tallied at left.

Principal public debt issues and their approximate current prices and yields of these very special trust issues are as follows:

Trust & issue	Price	Yield
Barnett Mtg. 6 3/4s'91	18b	37%
Barnett Mtg. 8½s'98	23b	37
Chase Man.Tr. 7 7/8s '78	52	15
Chase Man.Tr. 7½s'83	35½	21
Chase Man.Tr. 6½s'96 conv.	29	22
Cont.Mtg. 6¼s'96 conv.	12	52

Trust & Issue	Price	Yield
Grt.Amer.Mgmt. 7.55s'79	12b	63%
Grt.Amer.Mgmt. 8 3/4s'83	14b	62
Grt.Amer.Mgmt. 7s'89 conv.	15b	46
Guardian Mtg. 7½s'79	27 7/8	26
Guardian Mtg. 6 3/4s'86	24½	27

b--Bid price; offers wanted.

Our speculative preference points toward bonds of those REITs sponsored by the commercial banks, on the rationale that these large banks aren't likely to cut their offspring adrift. Bank sponsors in this list are Barnett Mortgage, Chase Manhattan Trust and Guardian Mortgage through a bank in its parent holding company. Pricing seems to bear out this reasoning, although as noted on page 8 there are some modest moves by regional banks to disassociate themselves in some way from the REITs they sponsored. Note too that bank pressure to repay loans via asset swaps could result in profits to these trusts; Continental Mtg. reported $12.8 million gain in September on swaps, stemming from reversal of loss provisions and accrued interest recovery.

THE HOTEL INVESTORS (10¼--ASE-HOT) FY AUG. 31

Portfolio dynamics: Fundings declined 13% in the last twelve months to $77 million reflecting the policy going back to early 1974 of not making new commitments. Over the next six months, however, fundings should increase about 10% but only because there is a $4.3 million unfunded commitment for a 200-room Hilton Inn in Long Beach, Cal. and the trust will be putting $3-4 million into improvements of existing properties. There has not been any change in fundamental philosophy. Construction loan activity is still halted and no other investments are planned. The entire portfolio is hotel connected. Equity orientation has increased to 47% of holdings compared with 39% a year ago. Of these, 19% is managed by a trust majority owned hotel service company and the other 29% is leased to prominent hotel chains, three to Ramada and one each to Marriott and TraveLodge. The remaining 53% of holdings consist of mortgage arrangements: 23% where the trust also owns the land, 23% where there are sales overrides or equity options, and 5% unfunded. Geographic location by hotels is scattered: four each are located in Texas and Missouri, three in California, two each in Arizona and Maryland, and seven others in seven states. Hotels are predominantly commercial catering to business traffic. As with most such hotels, there is some tourist traffic on weekends and sometimes during tourist seasons as with the Florida unit. All the trust's units are complete and standing.

There is only one problem property, an owned Hilton-franchised unit in Victorville, Cal. It has 167 rooms with a $3.4 million investment, 4.4% of assets. This July, foreclosure was completed and title taken by the trust. This hotel is being managed by the aforemention trust connected hotel service firm (Ace Foods). This facility is said to be run at a first class level and now breakeven after costing the trust at a rate of 20¢/sh. previously. Possible loss is believed covered by specific allocations to the loss reserve which stood at $1.95 million, 2½% of real estate holdings. One possible workout would be sale of this inn but with no earning drain, there is no immediate need for sale.

Financing: The trust is financed 57% by capital and 43% by non-convertible debt. Capital of $44.9 million is 63% equity and 37% convertible debt represented by two series, 7-3/4s of 1990 and 7½s of 1991. Straight debt of $34 million is 68% in 8½% intermediate-term bank notes and 32% secured mortgages. There is no short-term debt although there are $10 million unused credit lines. No financing is seen. The trust has $4 million certificates of deposit and planned additions to the Dallas hotel will be provided by an outside lender for the first mortgage. Sponsor: The trust is now self administered. The contract with the former adviser, Hotel Advisors, was cancelled effective Nov. 30. This ends the divergence of management philosophy between the outside trustees and former principals of the old adviser. The outside trustees apparently established a controlled growth approach as new commitments were halted in mid-1974. The former top two officers, who were part-owners of the old adviser, have left the trust.

Results & outlook: Operating results seem to be stabilizing if not bottoming out. The August quarter at $0.27/sh. was $0.08 below the May quarter but reflected a $0.05 writeoff and poor results at the Tallahassee, Fla. hotel. This Tallahassee property, mostly commercial, does benefit from seasonal tourist trade which was off this year. Not a problem in the full sense, return slipped to about 5%. Beyond straight earnings which were $1.27/sh. in fiscal 1975 and alone pay the dividend since depreciation is no longer being paid out regularly, the trust through increasing depreciation had net cash flow of $1.89 for the year, after $0.34 loss reserve provision, and will apparently provide cushion for the $0.35 quarterly dividend in some quarters when needed. Pertinent to the shares' evaluation, the cash flow multiple is a valid measure with a modest 5.4 times last year's $1.89. Yield is a respectable 13.7% based on the $0.35 quarterly. But perhaps more important to the shares' valuation and outlook for the trust is the relative success with which the trust came through recent recession. Its portfolio of all completed properties obviously earned a decent overall return. Occupancy held up better than the national average. Being commercially oriented,

they were apparently little affected by the gasoline shortage which impacted earlier in the year on tourist and recreational travel. For this reason, we believe the trust exhibited good hotel location and apparently successful specialized management required in this type of real estate. Where necessary, outside management was hired through the trust's affiliate. Top management at the trust itself has turned over but there seems to be adequate middle personnel and outside trustees appear dedicated. The chief officer said to be most responsible for uniting the outside trustees is 75-year old John Traynor who is retiring. He was replaced as president by Raymond Brophy, Washington, D.C. real estate developer. Overall the trust's shares merit our number "3" ranking and may be purchased for speculative income and value. The trust's two convertibles are worthwhile for less speculative income providing about 13% returns. (BS)

WELLS FARGO MORTGAGE INVESTORS (4-1/8--NYSE-WFM) FY June 30

Portfolio dynamics: Fundings dropped 20% in the last twelve months to $205 million on Sept. 30. This reflects conservative commitment policy which now leaves only $9 million undisbursed. Fundings are likely to decline 12% over the next few months. New commitments have been sought cautiously the past six months but few suitable investments have been found. By virtue of intent and necessity via foreclosure, the trust is now over 34% equity. Even without foreclosures, equity and holdings with equity features as partnerships and land purchase leasebacks account for over 23%. Breakdown by property type is: 43% apartments, 14% development, 10% condominiums, 7% industrial, 7% land, 6% single family, 5% office buildings, 2% mobile home parks and 1% each leased land, shopping centers, motels and other. Geographic location is western based: 30% California, 21% Texas, 16% Arizona, 8% Colorado, 6% Florida and the remaining 19% in ten other states.

The problem categories totalled $80.6 million on Sept. 30, or 39% of the portfolio. The net drag, however, is not as great as this number would imply. To begin with, $52 million, 64% of the total, is classified as partially earning. The trust is obtaining about a 3¼% return on a reporting basis from this segment, close to 4½% cash-on-cash. Moreover, this trust is among the few which has taken a good degree of control over many of its problems through foreclosure, $49.6 million. There is some overlapping, $31 million, or 62%, of foreclosures are at least partially earning. The recent breakdown of the $49.6 million in foreclosures was: $30 million apartments, $13 million land, $4.7 single family (including some condos) and $1.3 million income properties. In the absolute nonearning category of $28.2 million as of Oct. 31, $15.5 million was in land, $7.4 million in residential property being reduced through sales and $5.3 million in income properties. Land is obviously the furthest from resolution with an unknown time frame. But trust officials feel this residential and close-in land will be the earliest to go. Similarly, most problem properties are in the residential category which is generally headed for the shortest workout cycle among property types. In the meantime, operations are already improving slightly for the trust's apartments with higher occupancy rates and stabilizing utility costs. Finally, there is no longer any construction risk. The four incomplete projects are substantially complete.

Permanent financing for the trust's portfolio remains limited. Only $30 million currently has takeouts. And loans still tied to market interest rates are similarly thin. Only about 22% of the portfolio so floats with about half of this coming under ceilings.

Financing: Funds are 32% capital, all equity, and 68% debt. On Sept. 30, debt of $143 million was 45% commercial paper and 55% bank borrowings. By the end of Nov., debt shrunk to $131 million, 94% commercial paper. Although paper is unrated and not guaranteed by the parent, the trust's record and contacts have enabled it to be active in the short-term paper market. A disproportionate amount of funds float with market rates, 68%. Sponsor: Wells Fargo & Co., large California one bank holding company.

Results & outlook: Operating earnings dipped to $0.03/sh. in the Sept. quarter

from \$0.08 in the previous quarter. Slightly higher interest rates were partly responsible. Also, the foreclosed property account rose 48% in the Sept. quarter and boosted depreciation to \$0.05/sh. With market interest rates averaging slightly higher in the Dec. quarter, earnings will have no help on this score but should be offset by the larger percentage of financing via lower-cost commercial paper. Nonearning assets appear to be stablizing with the partial earning category improving its return. This should prove moderately beneficial. All told, operating earnings should at least stabilize the next few quarters, barring dramatic changes in interest rates. The way Wells Fargo is currently situated, working out its sick projects preperatory to refinancing or selling them, it is necessarily funded short term. It is therefore more at the mercy of money markets than most. The shares have this short-term risk overhanging them. Long-term though, workout potential appears considerable for the shares at 72% below \$17 book value believed essentially recoverable. Dividends will necessarily remain in abeyance until yearend, until some significant earning power is established. Underlying real estate appears decent. The trust relied on credit and capabilities of large developers which worked in most cases but still left it with high concentration with a few who did not make it. The shares are attractive for purchase within these conditions. (BS)

M&T MORTGAGE INVESTORS (6½--OTC-MTMIS) FY Aug. 31

Portfolio dynamics: Fundings declined 5% in the last twelve months, staying around the \$40 million level where they have been the last three years. Unfunded commitments are \$10 million and the portfolio will remain about the current level or dip slightly. This strictly localized lender operates in eight Texas cities, doing about half its business in Houston. Fundings are 66% construction and land development, 28% long-term (further breaking down: 3% FHA and VA, 24% conventional, 1% second mortgages) and 7% warehoused notes receivable. Properties are essentially single family home tracts except for 23% in a mix of small commercial loans making up most of the long-term financed category. About 66% of the portfolio floats with market.

The problem category totals \$1.4 million, 3½% of the portfolio. This is way below the group average and reflects the bank-like localized approach the trust has taken. Nonearning loans are essentially like the construction loan portfolio, single family tracts. These are small pieces. The loss reserve appears adequate at 0.9% of the portfolio (this comes to 27% of the nonearning category).

Financing: Fundings are 37% capital and 63% debt. Capital of \$15 million is all equity. Debt of \$25 million is in the form of short-term bank notes. These are secured by the trust's real estate mortgages which results in lower interest rates than a viable trust would normally pay. No compensating balances are required to support bank borrowings. Of funds, 63% float. Sponsor: Mortgage and Trust, Houston, Tex.; a fairly large mortgage banker.

Results & outlook: Operating earnings were \$0.21/sh. in the August quarter after deducting \$0.08 for loss reserve provision taken at yearend. The provision therefore accounted for the decline from the \$0.28 in the May quarter. The trust seems likely to maintain about this operating level and with it, the \$0.26 quarterly dividend which is only slightly below the peak payout of \$0.30 made two years ago. The current yield is 16% which is adequate reason for speculative income purchases. Prospects will hinge on homebuilding activity in Texas but only in varying somewhat from the base established by the trust in recent years. The adviser has proved itself with solid, respectable performance not aimed at simple asset growth. (BS)

GULF MORTGAGE AND REALTY INVESTMENTS (1-1/8--NYSE-GMR) FY Feb. 28

Portfolio dynamics: The portfolio was \$149 million on Aug. 31, virtually unchanged from a year ago. Unfunded commitments are under \$10 million and the portfolio will

remain level at most. There will be some shrinkage depending on availability of permanent financing for the sale of property and degree of loan swaps that can be negotiated. Swap negotiations are just underway and tentative. Projects in the portfolio are completed except for 9-10 for which the $6-7 million unfunded disbursements are to be spent. By category the portfolio breaks down: 27% long-term loans, 6% rental property, 26% construction loans, 17% land development and land loans, 11% standing loans and 13% foreclosures. By type: 30% apartments, 22% land & improvements, 15% motels/motor inns, 9% office buildings, 6% condos, 6% warehouses and 13% other. Geographically holdings are 69% southeast, 14% southwest, 8% northeast, 4% west, 4% mid-west and 2% other.

Nonearnings were $74.6 million on Aug. 31, 50% of real estate holdings. This figure is not thought to have changed much through October. Nonearnings divided into two parts: 25 loans for $43.7 million were nonaccruing (with $8.8 million in process of foreclosure). By type, these broke down: 15% motels, 11% condos, 20% land acquisition, 19% land development, 18% apartments, 11% office buildings and 6% other. The foreclosure category is $32.9 million earning a low (unstated) rate of return but improving. It broke down: 59% apartments, 9% condo apartments, 4% warehouses, 16% land, 6% motels and 6% office buldings. Workout prospects vary. As with all land, the time is indefinite. Most of the other problems do not seem worse than average. Few condos are held and these will probably be rented first to cut holding costs. Management is at least making an effort. By not qualifying as a trust for fiscal 1976, it can exercise managerial control. It has hired a property management staff now numbering 18, 5 just for apartments.

Financing: Fundings are 19% capital and 81% debt. Capital of $27 million is all equity. Debt of $116 million is 62% short term and 38% long term. Most of short-term debt is an $82 million revolving credit agreement with banks and a Eurodollar loan which expires Dec. 30. This agreement is currently being renegotiated with the trust seeking some rate relief. It is too early to guess what rate will be decided but in turn the rate will necessarily determine the trust's nearby earning power with so much of holdings under water. Sponsor: Gulf Life Holding, Jacksonville, Florida life insurance company.

Results & outlook: The trust reported a $0.38/sh. operating loss for the August quarter before $2.49 loss reserve provision. The October quarter was probably not much different although unconfirmed. The next few quarters will hinge on any possible rate relief granted under a new credit agreement. Interest presently is equal to 127% of prime. While not a better trust, indications are it will come through as a viable real estate entity in some form. Return to qualified trust status will depend on conditions the next few years and how successfully the trust works itself out. At least most of the property categories and markets they are in look within reason for workout. The shares selling at 9% of written down book value of $11.93/sh. have long-term potential and the 7.7% notes of 1980 provide speculative income as long as the senior creditors go along, and they should continue to. (BS)

NORTH AMERICAN MORTGAGE INVESTORS (5-1/8--NYSE-NAM) FY Dec. 31

Portfolio dynamics: Holdings of this short-term construction lending trust fell by $37½ million, or 17%, over the past year reflecting a decision nearly two years ago to trim commitments and fundings because of unattractive spreads. We expect no reversal of this policy until real estate and money markets improve. Portfolio fundings have been concentrated historically in standard urban income properties, mainly apartments, office buildings and shopping centers. Portfolio composition is believed to have changed little from Dec. 31, 1974, when the $220 million fundings and commitments were 29½% high-rise apartments, 29% garden apartments, 11% shopping centers, 9½% office buildings, 5.7% development loans, 2½% unimproved land, 5% hotels and motels, and the remainder industrial and miscellaneous. This mix has allowed the trust to escape most of the problems associated with condominiums, especially in Florida.

By investment type, holdings of $179.6 million were 84% mortgage loans, 11% acquired property producing income, and 5% acquired property not producing income. Mortgage loans are about 65% first mortgage construction loans, 20% first mortgages on completed projects, 10% second mortgage loans, and the remainder purchase money loans and subordinated land sales/leasebacks.

Problem loans have been well controlled historically, demonstrated by the fact that over two-thirds of acquired properties are producing some income. These income producing holdings range from a property acquired from Walter J. Kassuba now yielding its normal return to those below that mark. The trust loss reserve stood at $3 million at Sept. 30, equal to about 1.7% of net real estate investments, a ratio among the lowest for major construction lending trusts. NAM added $647,000 (or $0.15/sh.) to the reserve in the September quarter, largest quarterly addition to the reserve this year. The trust faces an audit by its accounting firm, Peat, Marwick, Mitchell & Co., at Dec. 31, first under the new and tougher guidelines adopted by the American Institute of Certified Public Accountants last summer (RTR, June 13 and 27). Outcome of such audit is, as always, uncertain. A year ago the audit was conducted under PMM guidelines requiring an estimate of holding costs for all properties expected to be held over two years; this year the holding costs must be applied to all properties held. With all acquired properties rising from $15.3 million to $28.1 million currently, some additions to this holding cost component of the loss reserve may be expected, although the fact that well over half of acquired properties produce income for NAM may blunt impact of this new rule. NAM management has taken a lead among REITs in challenging application of the AICPA guideline on all REITs until management can determine that a loss is probable, and that magnitude of this loss can be estimated.

Financing: North American is funded 31½% by shareholder equity and 68½% by non-convertible debt. Shareholder equity of $61.9 million is represented by 4.40M shares. Total debt of $134.3 million is 48% short-term bank lines, 27% commercial paper, 21% of 5½% subordinated debentures due March 1979, and 4% mortgage debt. NAM commericial paper is rated P-2 by Moody's Investors Service and this rating enables the trust to remain one of the very select group of short-term trusts still able to tap this market. Rates are slightly higher than for industrial paper, however. The leverage ratio of all debt equaling 2.17 times equity is down a bit from previous quarters and bespeaks conservative financial posture. Sponsor: Sonnenblick-Goldman Corp., national mortgage brokers and bankers.

Results and outlook: September quarter net of $0.12/share was flat with the previous quarter but components of income shifted. The quarter included special gains of 6-cents each from retirement of $1 million of the 5½% debentures and collection on settlement of a claim. Management offset these two special items by adding 15-cents to the loss reserve, about 9-cents higher than the previous quarter. Dominating the stock's outlook is results of the impending December year-end audit. Market price of the shares have slipped to new lows as investors assess impact of the audit. The trust has already announced that it will adopt new methods of accounting for commitment fees at year-end but currently is not able to quantify impact of this change. In this connection Realty & Mortgage Investors of the Pacific recently adopted this same policy of spreading commitment fee income over the life of the commitment; partly as a result, income fell to 10-cents a share in the fourth (November) quarter, vs. 30-cents the previous quarter. RAMPAC declared a 30-cent dividend notwithstanding the reduced earnings, because such fee amortization is not recognized for IRS purposes. NAM has paid 25-cents each quarter this year, distributing some cash flow, and the accounting change on commitment fees should not disturb that, assuming that the year-end audit does not require major loss reserve additions. Recent portfolio details are forthcoming. We would keep our powder dry on the shares until audited results are available. (KDC)

NEW NOTES: TALK OF MERGERS AND TENDERS STIRRING AS BANKS SEEK DISASSOCIATION

Old Stone Corp., bank holding company, said directors have expressed an interest in acquiring Old Stone Mortgage & Realty Trust, subject to negotiation of mutually agreeable terms. The Providence, R.I. holding company sponsors the trust. The move reflects banking industry desire to de-emphasize its sponsorship role in REITs.